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SUBJECT: CYPRUS GETS PRELIMINARY ECOFIN GO-AHEAD TO JOIN EUROZONE;
JULY 10 NEXT KEY DATE

REF: A) NICOSIA 439 B) NICOSIA 247 C) NICOSIA 144

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(U) This cable is sensitive but unclassified. Please treat accordingly.

11. (SBU) Summary. As expected, EU finance ministers gave Cyprus (and Malta) a preliminary green light to adopt the Euro effective January 1, 2008, at the June 4-5 ECOFIN meeting. The finance ministers are expected to give final approval at the July 10 ECOFIN meeting, where they will also establish the rate at which the Cypriot pound will be converted into Euro. European heads of state will also discuss Cyprus planned entry into the Eurozone at the June 21-22 European Council (EU Summit) Meeting. There are some signs that the GoC's much criticized Euro public information campaign is finally producing results, although polls still show roughly half of Cypriots unhappy about giving up the Cyprus pound, and only 38 percent believe that Euro adoption is in Cyprus's best interest. Despite comments from Turkish Cypriot leader Talat that introduction of the Euro will complicate efforts toward reunification of the island (the Turkish Cypriot community will continue to use the Turkish Lira) Euro adoption should actually make reunification easier by removing the contentious issue of what currency a united Cyprus would use. End Summary.

Finance Ministers Give Initial Approval; July 10 Key Date

12. (SBU) Based on earlier recommendations of the European Commission and the European Central Bank (ref a), the European finance ministers gave Cyprus (and Malta) initial approval to join the Eurozone effective January 1, 2008, at the June 4-5 ECOFIN meeting. Final approval is expected to come from the finance ministers at the July 10 ECOFIN meeting, which will also set the rate at which the Cyprus Pound will be converted into Euro. The enlargement of the Eurozone will also be on the agenda of the June 21-22 meeting of EU heads of state (European Council). Cyprus and Malta will be the fourteenth and fifteenth EU member states to adopt the Euro. According to the press, Cyprus and Malta will increase the Eurozone's population by an additional 1.2 million citizens and its collective GDP by only 0.2 percent.

Fears of Political Linkage to Euro Adoption Seem Unfounded

¶3. (SBU) Despite initial Cypriot fears that some EU member states might try to link approval for Euro adoption to progress on the Cyprus issue (ref a), EU finance ministers were unanimous in their support for Cyprus's (and Malta's) Euro aspirations at their June 4-5 meeting. Although few expect the EU to part with previous practice and introduce political considerations into what has been heretofore a strictly technical process, Cyprus is likely to continue to be on its best behavior in Europe until at least after the July 10 ECOFIN meeting.

Attitudes Toward Euro Improving Slowly, Lot Left to Do

¶4. (SBU) Despite some improvement over the past six months, May's Eurobarometer poll (using data from March and April) continues to show significant skepticism among ordinary Cypriots toward adopting the Euro as well as wide-spread ignorance about the Euro itself. The percentage of Cypriots unhappy about adopting the Euro fell from 58 percent in September to 49 percent in March. Only 38 percent (up from 29 percent in September) reported that they expected the Euro to have positive consequences for the country, the lowest among the new EU members. Nearly 83 percent of Cypriots (the most among new members) expects to be cheated during the changeover. While 62 percent of Cypriots reported that they did not feel well informed about the Euro, 43 percent were not aware that Euro banknotes are the same in all countries. The figures suggest that the GoC's Euro public information campaign -- which has been strongly criticized by the European Union (ref a) -- is making some inroads but still has a lot of work left.

Turkish Cypriots Will Continue to Use the Turkish Lira

¶5. (SBU) While the government controlled area of Cyprus will now almost certainly adopt the Euro on January 1, 2008, the Turkish Cypriot community will continue to formally use the Turkish Lira -- although a lot of transactions will continue to take place in pounds

sterling, U.S. dollars and the Euro. Although there may be economic benefits for the Turkish Cypriot community to unilaterally adopt the Euro simultaneously with the south, both EU and, more importantly, Turkish opposition would appear to make this politically impossible.

Unfounded Fears that Euro will Complicate Settlement

¶6. (SBU) Turkish Cypriot leader Talat has raised concerns in the press that the south's adoption of the Euro could further complicate efforts toward reunification of the island. He is quoted as telling the press that adoption of the Euro "would be an opportunity if the Greek Cypriots acted in a positive way. But as they are trying to consolidate the restrictions on Turkish Cypriots [it could play] a very negative role," and that the GoC might use the stability and growth pact rules that accompany Euro adoption "as a pretext for promoting the status quo."

¶7. (SBU) Among those who agree with Talat, there appear to be three main arguments why Cyprus's adoption of the Euro could complicate settlement efforts:

-- 1) Since the EU did not buck precedent and link Eurozone entry to progress on the Cyprus problem, the GoC now has everything it wants, and thus has no reason to come to the table. This assumes that the Greek Cypriots' only motivation toward pursuing a settlement is joining EU structures. In truth, they would appear to have a number of incentives to support a reunification, including the return of or restitution of property.

-- 2) Any settlement will require significant governmental spending to overcome the structural challenges involved. In adopting the Euro Cyprus will be bound by the rules of the EU's stability and growth pact, which among other things prohibits Eurozone members from having a budget deficit greater than three percent of GDP. This provides a significant pretext for opposing the governmental spending that will be required in any future settlement. In 2005, however, the EU reformed the stability and growth pact rules to allow countries to exceed the three percent limit in extraordinary circumstances, including efforts toward European reunification. There is also a precedent for violating the three percent rule, as

Germany used the new provision to successfully justify part of its budget deficit as being linked to the continuing costs of German reunification. Through its efforts to adopt the Euro, the GoC has brought its budget deficit down to 1.5 percent with the goal of reducing it to 0.5 percent within eighteen months. This gives the GoC considerably more latitude in being able to shoulder the fiscal burden of a future settlement. By contrast, when the Annan Plan was being debated, the GoC's budget deficit was around six percent.

-- 3) Euro adoption will lead to increased economic growth in the south, which will exacerbate the economic disparity between the communities, making any future settlement more difficult. Maybe, but the answer to this is to increase economic opportunities and growth in the Turkish Cypriot community rather than to hold the Greek Cypriot community back.

18. (SBU) Cyprus's adoption of the Euro will simplify efforts toward a settlement by removing the contentious issue of which currency a united Cyprus should use. The Annan plan negotiations on this issue were particularly difficult given the symbolism of accepting to use the other's currency, and the final compromise did not seem to satisfy anyone. As part of any future settlement, the suspension of the *acquis* in the Turkish Cypriot community would be lifted, and all of Cyprus would become part of the EU and part of the Eurozone.

Comment

19. (SBU) Cyprus's adoption of the Euro on January 1, 2008, is now almost a complete certainty. The main question continues to be whether the GoC can ensure a smooth transition. While the technical preparations appear to be on track, the GoC's much criticized public information campaign has considerable more work to do. Talat's negative comments on the south's adoption of the Euro appear to stem more from the Turkish Cypriot community's growing frustration and the zero-sum thinking that dominates political discussion on the island than reasoned opinion. Rather than further complicating efforts toward reunification, Cyprus's adoption of the Euro should

in fact simplify work toward a settlement by removing the contentious issue of which currency a united Cyprus would use. Unfortunately, however, this is only one of many contentious issues that must be solved before any settlement can be reached.

ZIMMERMAN